Transparency of land markets: not only a matter of market outcomes

Experiences from the Netherlands

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What can be done to understand land markets better? As a result of the financial crisis, in many countries pleas are being made for more accurate valuations of real estate and land. Policy-makers want land markets to be more transparent. Although it is obviously worthwhile to improve valuation practices, it needs to be realised that there are limits to the accuracy of valuations. These limits relate to the very nature of land as an immobile and durable good. But more importantly, the question is: do better valuations lead to more transparent markets? This article claims that we should not be preoccupied with market outcomes, such as prices and values of land. More transparency is achieved when we gain a better view on the market processes and the institutions that lead to these outcomes.

Land markets in France have proven to be very volatile. Recently, there appears to be a demand for greater transparency in the land market so as to be able to follow and predict changes in demand-supply relationships. The question is: how can this be done? A discussion has started about improving and synchronising the valuation methods and techniques in order to come to one reliable technique that can be used to get an up-to-date and comprehensive image of the state of affairs on the land market.

The intent of this paper[1] is to reflect on this discussion on the basis of knowledge from and experiences with the Dutch land market. The Dutch experience might offer an interesting reference point. Not only because France and the Netherlands share many things. For instance, they both have a Napoleonic legal system and, in line with that, have long tradition of land registry[2]. But also because there are differences. For instance, the Dutch land market is characterised by strong government involvement (especially local government), even though that involvement is under pressure (Buitelaar, 2010)[3], while in France the government is much less actively involved.

[1] This article is based on a presentation held at the ADEF conference 'Évaluation Foncière; l'improbable certitude' in Paris on 8 June 2012.

[2] In fact, the Netherlands had the first national land registry in the world (Scott, 1998). An important difference with the French Cadastre is that the Dutch is only concerned with recording transactions, and not with taxation. The latter is a local government responsibility.

[3] This pressure increased already before the crisis due to increased land rents, changes in the social housing sector, European public procurement and state-aid rules and a shift from greenfield to brownfield development (Buitelaar, 2010), but has increased since the crisis when the financial risks of an active land policy became painfully manifest. Decreasing demand for real estate and housing has brought development to a hold which has led to financial losses on land development. It has already accumulated to several hundreds of millions of euros for all local authorities together (Deloitte, 2011).

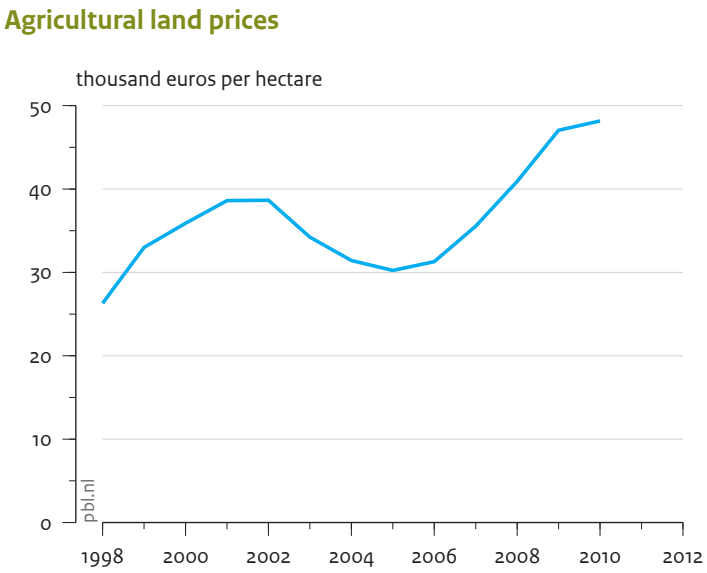
The Dutch experience is used to support the claim that there are inherent limits to achieving transparency in the land market, limits that are related to the nature of the good 'land'. But maybe more importantly, it will be argued that a preoccupation with land prices and values, in other words with market *outcomes*, is proof of a limited view on transparency. In order to really understand markets and market developments, we need insight in the market *processes* that lead to these outcomes.

The limitations to transparency of an immobile and durable good

It has been argued before: land and property markets are special markets (e.g. Evans, 2004). Land and property have specific features. They are immobile and durable. The consequence of that is that there are few trades compared to many markets in mobile goods, also compared to other investment goods such as equities and bonds. And because every piece of land is unique, in terms of for instance soil and locational features, the land price of one plot or one square meter cannot easily be treated as a *proxy* for the other.

In addition, not only does every piece of land have its own unique features, so does every transaction. In housing markets house prices reflect the value of the transaction nicely, in general. But in the case of the land market, at the least in the Netherlands, contracts over plots of (building) land consist of many additional conditions that have a value that is not incorporated in the land price (Segeren, 2007). For instance, agreements are made about future land uses, building rights, leases, future transactions or about other plots than the one that is traded. In other words, the land price often does not tell us much about the value of the transaction.
The few trades, together with the additional conditions, lead to a situation where land prices are far from perfect indicators of the market situation and therefore of market volatility. In the Netherlands, land registry data on land prices are hardly used to monitor land market developments. If land prices are used at all, other data sources are used. For serviced industrial land, asking prices, as set by local authorities, are used. These are collected by IBIS[4]. And for agricultural land prices, we often depend on the data that DLG[5] assembles and edits on a yearly basis (see Figure 1).

Figure 1: *Development of prices for agricultural land in the Netherlands 1998 - 2010*



DLG makes sure that only transactions are included of land that is in continuing agricultural use, hence excluding land that is bought for property development.

Source: DLG, edited by the author

[4] IBIS stands for 'Integraal Bedrijventerreinen Informatiesysteem' (integrated information system for industrial estates).
[5] DLG stands for 'Dienst Landelijk Gebied' (department rural areas).

Valuations as a means to market transparency

Because of the problems with land prices, compared to other markets, land (and property) markets rely heavily on valuations made by specialised surveyors. Since both public and private actors in Dutch land markets are increasingly using a *residual valuation* method, land valuations are closely linked with and derived from property valuations. With the land and property market bust, valuations are being debated. Are they capturing market developments sufficiently? They seem to be relatively slack in picking up market downturns.

Valuations are obviously the work of humans and are therefore subjective, hence evidently imperfect, despite the emergence of computerised mass appraisal methods. To give, nevertheless, guidance to that subjective estimation, surveyors make use of standards. However, every country seems to have its own standards, even though there are also many similarities. And even within countries there is often no generic method. For different purposes there are different methods. In the Netherlands, for instance, valuations for property taxes differ from those that corporate taxes are based on. And these are again different from valuations used for investment decisions.

But also for the same purposes there are different ways of valuing. Housing associations in the Netherlands estimate the value of their housing stock differently form real estate investors that own similar houses. Housing associations use a *use value* method while investors estimate *market values.* Conijn & Schilder (2009) estimate that if Dutch housing associations used a market value approach the valuation of their stock, the value of all 2,4 million units would be three times as high.

Also different investors use different valuations to base their investment decision on, although it seems as if most large investors nowadays use the more sophisticated *Discounted Cash Flow* (DCF) method, instead of the more crude initial yield method. Property developers, however, often use the more crude *gross-yield* method.

Regardless of the variances in method, there are some general problems in determining an accurate land or property value. I mention two important problems. The first has to do with the earlier mentioned 'problem' of additional conditions to a transaction. In the case of property, investors in the Netherlands use rent incentives to attract tenants. These are not reflected in the officially registered rents. Such incentives are not always sufficiently taken into account in valuations, while they can have a large value, especially in demand markets. Van Gool (2011) estimates that in the obsolete and unattractive office location of Amsterdam Zuidoost the value of the rent incentives is 30% of the gross rent, while for the high-demand office locations in the city centre of Amsterdam this is only 6%.
Second, valuations suffer from *lagging* and *smoothing*. Because valuations are often partly based on previous valuations, fluctuations in land and property values tend to be lagged and smoothed (Van Gool et al., 2007). This reduces market volatility and therefore hampers an accurate insight in land market booms and busts.

Beyond market outcomes: attention for market processes

There are problems with land prices and valuations. A more fundamental question, however, is whether accurate information on land prices and values makes a land market transparent. It might me a necessary condition, it is definitely not sufficient. In order to really get an insight and understand the working of land markets, in-depth knowledge of the interests, positions and strategies of actors such housing associations, local authorities, real estate investors, property developers is pivotal. As well knowledge of the informal and formal rules that structure their behaviour (see also Healey, 1992). Formal rules are written rules enforced by the court such as laws, ordinances, land-use plans and so on. Informal rules are the conventions, codes of behaviour, taboos and working procedures people make to guide social behaviour. These are subtle but often very important factors in the working of the market, in many cases probably more important than formal rules. This will be illustrated by two examples.

First, and in fact I have already referred to this, there are informal institutions with regard to valuation. Different countries, different sectors and different groups of organisations within sectors have developed different valuation norms and standards (i.e. institutions). These valuation standards have an important effect on how actors behave and hence on market outcomes. In the Netherlands, for instance, structural overvaluation of offices has long concealed a relatively low demand for office space, hence maintaining relatively high investment levels and reinforcing oversupply.
Another example of the interplay between actors, institutions and market outcomes can be found in the Dutch land market for industrial estates. Dutch local authorities develop around 75% of the industrial estates. They buy land, service it and then sell it off to end-users or investors who then build industrial real estate. Because local authorities assume they are in competition with each other over the settlement of firms (and, related to that, jobs), they want to keep land prices as low as possible, at least compared to neighbouring authorities. As a result, asking prices for industrial land are determined comparatively rather than residually. Therefore, land prices for serviced industrial land are relatively low, compared to other property segments such as housing, retail and office space. The Dutch average is around 100 euro per square meter of serviced industrial land. One effect of that is that for companies it is financially much more attractive to buy new land to develop new properties than to regenerate existing ones (PBL, 2009).

An institutional analysis deepens our understanding of the land market, hence making the market more transparent (Needham, Segeren & Buitelaar, 2011). A better understanding of the market processes that produce land and property prices helps to come to better policy suggestions for structuring land markets.

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